Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

2 December 2019
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Accounting and Financial Reporting

Instructions to examinees:
(i) Answer all **FIVE** questions.
(ii) Answer in black pen only.

Q.1 Krona Limited (KL) produces various nutrition products through its three production facilities located at Karachi, Lahore and Peshawar. Each facility is considered as a separate cash-generating unit (CGU).

In May 2019, several contamination cases of KL's products were reported on social media as well as on TV channels. The adverse publicity badly affected all the products and consequently their sales were reduced significantly. Therefore, KL conducted impairment test of all CGUs as on 30 June 2019 though KL does not have any intention to sell any CGU in near future.

Following information was made available on 30 June 2019:

(i) **Assets of CGUs:**

	Karachi	**Lahore**	**Peshawar**
	------------- Rs. in million -------------		
Carrying amount before impairment	160	100	125
Value in use	155	115	164
Fair value less costs to sell	152	110	169
	------------- No. of years -------------		
Remaining average useful life	10	8	6

(ii) **Corporate assets:**

	Carrying amount before impairment	**Remaining average useful life**
	Rs. in million	**No. of years**
Head office assets	84	15
Product development centre	26	5

(iii) The operations are conducted from the head office. Product development centre supports Karachi and Lahore facilities only.

Required:
(a) Compute carrying amounts of each CGU and corporate asset after incorporating impairment losses under the following independent situations:
   (i) The relative carrying amounts of CGUs are reasonable indication of the proportion of the corporate assets devoted to each CGU. **(08)**
   (ii) The carrying amounts of the corporate assets cannot be allocated on a reasonable basis to the individual CGUs. **(10)**

(b) Briefly explain why the total impairment loss in each of the above situations is different. **(02)**

Q.2 You are the Finance Manager of Dirham Limited (DL). Your assistant has prepared draft financial statements of DL for the year ended 31 December 2018. However, he could not prepare statement of changes in equity due to certain outstanding issues.

For the purpose of preparation of statement of changes in equity, the following information is available:

(i) Share capital and reserves as on 31 December:

	2017	2016	2015
	----------- Rs. in million -----------		
Share capital (Rs. 10 each)	700	700	700
Retained earnings	1,013	702	530
Revaluation surplus	281	172	151

(ii) Net profit for 2018 (draft), 2017 (audited) and 2016 (audited) were Rs. 198 million, Rs. 311 million and Rs. 242 million respectively.

(iii) The draft statement of financial position as on 31 December 2018 shows total assets and total liabilities of Rs. 2,977 million and Rs. 785 million respectively.

Details of outstanding issues:

(i) In 2018, it was discovered that a senior executive was granted share options on 1 January 2016 but nothing was recorded in the books in 2016 as well as in subsequent years.

DL had granted 120,000 share options to the senior executive, conditional upon the executive remaining in DL's employment till 31 December 2019. The exercise price per option is Rs. 90. However, the exercise price drops to Rs. 50 if DL's net profit increases by at least 8% in each year.

Estimated fair values of share option are as under:

	On grant date	On 31-Dec-2018
	--------- Rs. per option ---------	
Exercise price of Rs. 90	150	190
Exercise price of Rs. 50	175	225

The increase in net profit by more than 8% was always expected. However, due to unexpected economic conditions, DL could not achieve 8% increase in profits in 2018.

(ii) In view of significant changes in the technology, it has been decided to reduce the remaining useful life of a plant by 5 years. No entry has been made for depreciation on the plant and adjustments in related decommissioning cost for 2018.

As at 1 January 2018, the plant had a carrying value of Rs. 150 million and a remaining useful life of 11 years. Further, in respect of this plant, revaluation surplus of Rs. 24 million and provision for decommissioning cost of Rs. 40 million were also appearing in the books as at that date. There is no change in expected decommissioning cost except for the timing due to change in useful life. Applicable discount rate is 11% per annum.

It is the policy of DL to transfer revaluation surplus to retained earnings only upon disposal.

(iii) It was noted that investment in debentures has not been accounted for correctly.

On 1 January 2018, DL purchased 2.5 million debentures (having face value of Rs. 100 each) issued by Peso Limited. Debentures were purchased at Rs. 103 each. However, the fair value of each debenture as on the date of purchase was Rs. 105 in the quoted market. Transaction cost of Rs. 1.5 million was also incurred on purchase of debentures.

Coupon rate of debentures is 12% which is payable annually on 31 December. DL has classified the investment in debentures as financial asset at fair value through other comprehensive income. At initial recognition, DL determined that debenture was not credit impaired.

DL estimated that 12 months expected credit losses in respect of the investment in debentures at 1 January 2018 and 31 December 2018 amounted to Rs. 8 million and Rs. 6 million respectively. As on 31 December 2018, the debentures were quoted on Pakistan Stock Exchange at Rs. 109 each.

Upon purchase, transaction price was recorded as financial asset whereas the transaction cost was charged to profit or loss. Interest has been received and taken to profit or loss. No further entries have been made in the books.

(iv) The following information has been received from actuary in respect of DL's pension fund for the year ended 31 December 2018:

	Rs. in million
Contribution paid	40
Benefits paid	32
Current service cost	45
Re-measurement gain	18*

***Re-measurements were nil in 2017 and 2016.*

Applicable annual discount rate and net pension liability as on 1 January 2018 were 10% and Rs. 85 million respectively.

During the year, payments made by DL were charged to profit or loss. No further adjustment has been made.

Required:

(a) Determine the revised amounts of total assets and total liabilities after incorporating effects of the above corrections. **(15)**

(b) Prepare DL's statement of changes in equity for the year ended 31 December 2018 along with comparative figures after incorporating effects of the above corrections, if any. ***(Ignore taxation. 'Total' column is not required)*** **(10)**

Q.3 International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) applies to all entities that do not have public accountability. The users of financial statements of these entities have a different focus from those interested in listed companies. IFRS for SMEs attempts to meet the users' needs while balancing the costs and benefits to preparers. It does not require preparers of financial statements to cross-refer to full IFRS.

Required:

Discuss any **eight** key differences between requirements of IFRS for SMEs and full IFRS. **(12)**

Q.4 The draft statements of financial position of Ruble Limited (RL), Taka Limited (TL) and Yuan Limited (YL) as on 31 December 2018 are as under:

	RL	TL	YL
	---------- Rs. in million ----------		
Assets:			
Property, plant and equipment	7,450	3,000	2,450
Investment in TL at cost	1,300	-	-
Investment in YL at cost	900	-	-
Current assets	650	500	400
	10,300	**3,500**	**2,850**
Equity and liabilities:			
Share capital	4,000	800	1,600
Share premium	1,100	225	-
Retained earnings	2,300	1,200	380
Bank loan	1,700	800	520
Deferred tax	250	120	15
Current liabilities	950	355	335
	10,300	**3,500**	**2,850**

Other information:

(i) On 1 January 2018, RL acquired 80% shares of TL from Shilling Limited (SL) at the following consideration:

- Cash payment of Rs. 1,300 million.
- Transfer of RL's freehold land having carrying value and fair value of Rs. 300 million and Rs. 450 million respectively.
- A bank loan payable by SL was transferred to RL. The principal amount of Rs. 200 million is repayable on 31 December 2022 and it carries interest at 12% payable annually in arrears on 31 December each year. On the date of acquisition, the prevailing interest rate for the similar loan was 15% per annum.

The bank loan and transfer of land have not yet been recorded by RL. However, interest on the loan was paid by RL on the due date and charged to expense.

(ii) On the date of acquisition:

- TL's retained earnings were Rs. 750 million.
- Fair values of TL's net assets recorded in the books were equal to their carrying values except for a building whose fair value was higher than its carrying value by Rs. 250 million out of which Rs. 70 million relates to freehold land component. The building had a remaining useful life of 7.5 years.
- A contingent liability of Rs. 60 million was disclosed in the financial statements of TL. RL's legal adviser had at that time estimated that TL would be liable to pay Rs. 40 million to settle the claim. As at 31 December 2018, it was still appearing as contingent liability in TL's financial statements.

(iii) During the year, the following intra-group transactions took place:

	Sales	Included in buyer's closing inventory	Profit % on sales
	------------- Rs. in million -------------		
RL to TL	500	100	15%
TL to RL	800	150	25%

(iv) On 1 June 2018, RL entered into an agreement with Franc Limited (FL) to set up YL, a joint arrangement. RL has 60% right to the net assets of YL. RL and FL have agreed that YL's profit will not be distributed in near future.

(v) Applicable tax rates for RL, TL and YL are 25%, 30% and 20% respectively. Gain on disposal of land is exempt from tax. Interest expense is allowed under the tax laws on payment basis.

(vi) RL values non-controlling interest on the date of acquisition at its proportionate share of the fair value of the subsidiary's identifiable net assets.

Required:
Prepare RL's consolidated statement of financial position as on 31 December 2018 in accordance with the requirement of IFRS. ***(Incorporate effect of tax, if any)*** **(25)**

Q.5 Lira and Co., Chartered Accountants (LCCA) is considering the impact of possible adoption of IFRS 15 'Revenue from Contracts with Customers' on its revenues. In this regard, the Finance Manager of LCCA has sought your advice on the following matters:

(i) At LCCA's year end, external audits of the financial statements of various clients are in progress. LCCA usually raises bills for such audits on signing of the audit report when LCCA's enforceable right to payment has been established. However, in some other cases, LCCA has an enforceable right to payment for the work done to date which is non-refundable unless LCCA fails to complete the audit. In these cases, progress bills are raised by LCCA.

(ii) LCCA has a contract with a client to provide assistance to the client's internal audit department for a period of 3 years. The work is performed in complete coordination with client's internal audit personnel and any issues identified during the course of audit are immediately brought to the knowledge of the client.

Client's internal audit plan is agreed in advance with LCCA. Only few internal audits are scheduled in the months of July and August as compared to other months, due to post year end work load at client's other departments. LCCA deputes staff on need basis. Contract price is billed in six equal instalments through bills raised in arrears at the end of each half year on 30 June and 31 December.

(iii) LCCA provides/arranges employees on secondment basis to a local client and also to its network firms abroad. In this respect, LCCA receives full amount each month and then disburses employees' share.

The local client requests for the specific persons which are then hired by LCCA exclusively for the client. LCCA is not responsible for ensuring that the services are performed by the employees in accordance with the terms and conditions of the contract. Consideration received by LCCA is different for each employee and is based on negotiations between employee and the client.

Network firms request for any suitable personnel for their field work. LCCA then selects from its existing employees and seconds them to the network firms. Consideration received by LCCA for each employee is same and is based on negotiations between LCCA and the network firm.

Required:

(a) In respect of (i) and (ii), discuss **when** revenue should be recognized by LCCA. For each situation where revenue is to be recognized over time, suggest an appropriate **method for measuring progress** towards complete satisfaction of the performance obligation. ***Assume that LCCA's year end is 31 October.*** **(10)**

(b) In respect of (iii), discuss whether the revenue should be recorded as 'Net amount' (i.e. after deducting employees' share) or 'Gross amount'. **(08)**

(THE END)